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TAGS: EFIN ECON PGOV FR
SUBJECT: GOVERNMENT SELLS ADDITIONAL 2.5 PERCENT STAKE IN FRANCE TELECOM

Ref: Paris 2741

¶1. SUMMARY: To reduce the public debt, the government sold shares in France Telecom, the French telephone provider, reducing its stake in the company by 5.0 percent to 27.4 percent. The demand from institutional investors was not sufficient to sell a larger stake. The proceeds (2.65 billion euros or 3.6 billion USD) are symbolic compared with the public debt, which is currently over one trillion euros (1.5 billion USD). Proceeds from government real estate sales have been more significant to reduce the public debt. END SUMMARY

Sale of a 5 Percent Stake in France Telecom fell short
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¶2. On June 25, newly-appointed Finance Minister Christine Lagarde announced a government plan to reduce its stake in France Telecom by 5.0-7.0 percent, and to fully use proceeds for public debt reduction. The government intended to sell 130 million shares, but that number could have been increased to 180 million, or 7 percent of the capital, depending on the demand from institutional investors. In less than 24 hours, the government sold shares to institutional investors through "an accelerated book building process." The government chose this period as France Telecom stock price had already increased more than 26 percent in the last twelve months. Morgan Stanley, one of the lead managers of the sale with Morgan Stanley, Societe Generale, ABN Amro Rothschild, Citigroup Inc and Goldman Sachs, expected France Telecom share to be priced between 20.4 and 20.7 euros. However, stock market conditions were less favorable than expected on June 26 as the CAC 40 index decreased. The France Telecom share was priced at 20.4 euros, the low end of the range expected by banks, and institutional investors only applied for 130 million shares.

GOF keeps a 27.4 percent stake in France Telecom
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¶4. The government now holds a 27.4 percent stake, directly or indirectly, through ERAP, the public establishment that manages France Telecom's capital. France Telecom was privatized in September 2004, and the government lost its 33.3 percent blocking minority in the company in August 2005 when it reduced its stake to 32.41 percent. Lagarde said that "the government intends to remain a significant shareholder in France Telecom in the medium-term", in a reply to unions which wondered when the sale of "family jewels" would end. Three weeks earlier, one third of France Telecom employees went on strike due to "pressure" they said they felt to leave the company.

¶5. France Telecom is one of world's largest telecommunications companies in terms of customer totals and revenue. On June 25, 2007, the company, which is quoted on the NYSE, filed its annual

report for the year 2006 with SEC on form 20-F, which presents supplemental disclosures required under US GAAP and SEC regulations applicable to the company, including a reconciliation of France Telecom's consolidated financial statements prepared in accordance with IFRS to US GAAP. See: (http://www.francetelecom.com/en/financials /investors/data/report/2006)

Privatization Proceeds to Reduce Public Debt
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¶6. The sale netted the government 2.65 billion euros (3.6 billion USD), below the 3.8 billion euro government target. Proceeds will help reduce the public debt, which stood at 1.142 billion euros or 63.7 percent of GDP in 2006, well above the 60 percent limit set by the EU stability and growth pact. President Sarkozy's plan is to balance the budget and reduce the public debt below the EU limit of 60 percent of GDP by 2012, when his mandate ends.

Future Government Privatization Plans Still Unclear
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¶7. Observers had expected the government to sell shares in the electricity utility company EDF in which it still holds an 87 stake, while the law authorizes a reduction to 70 percent. But, Lagarde said that the government "has no intention to decrease significantly" its stake in EDF. The government is in the process of reviewing its investment strategy for industrial purposes (in the natural gas sector for instance) or for more political reasons (in the sectors of defense and public safety). The Agency of Government Holdings ("Agence des participations de l'Etat - APE") estimates government shares in listed companies at 192.3 billion euros (259 billion USD) in 2006. The government has still stake in large listed companies: 80 percent in the utility Gaz de France, 68 percent in Aeroports de Paris, 15 percent in Renault, 15 percent in EADS, 31 percent in Safran, 27 percent in Thales and 19 percent in



Air France-KLM. The government has also stakes in a myriad of minority or majority-held companies, notably in unlisted companies including an indirect 84 percent stake in the nuclear group Areva.

Comment
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¶8. The government uses privatization proceeds to reduce the public debt, as European regulations forbid using privatization proceeds to reduce the budget deficit. The deficit stood at 2.5 percent of GDP in 2006, but is likely to rise close to 3.0 percent by 2008 due to the tax package (reftel). The money raised by the sale of France Telecom shares is trivial compared to the 1.1 billion euro (1.5 billion USD) total debt. In a move to reduce the public debt, the government has also been selling government real estate, and has created a special government fund to collect 15 percent of those sales. In 2006, the government raised 800 million euros (1.1 USD billion) in real estate sales - or 1.2 billion euros (1.6 USD billion) if including the real estate owned by Reseau Ferre de France, the company that owns and maintains the French national railway network. As usual, selling real estate and shares in companies is a much easier way to reduce the public debt than paring down government spending.

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